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THE OPERATION OF THE MASSACHUSETTS INCOME TAX

SUMMARY

I. The Administration of the tax, 525. — II. The financial results, 528. — III. Comparison with the taxation of intangible property under the general property tax, 531.

I. THE ADMINISTRATION OF THE TAX

THE Massachusetts income tax went into operation in the year 1917, and its results are now a matter of record.¹ As explained in a previous number of this Journal,² the administration of the tax was placed wholly in the hands of the tax commissioner, who was authorized to appoint an income tax deputy and to divide the state into assessment districts. The deputy was appointed in the summer of 1916, and by the end of the year an efficient administrative staff had been created, the state being divided into ten assessment districts. During the last months of the year a campaign of publicity was inaugurated, with a view to acquainting the people of the commonwealth with the requirements of the new law. Literature was extensively circulated, and a corps of speakers organized who responded to many calls from various cities and towns. Banks and other similar institutions aided greatly in this campaign by circulating literature and establishing information bureaus for the use of their customers. Finally, the income tax department sent representatives to every city and town at stated times to meet tax-

¹ Report of the Tax Commissioner, 1917.

² Quarterly Journal of Economics, November, 1916

payers and assist them in complying with the requirements of the law.

The result was a very general compliance with the requirement of returns of taxable income. No less than 183,000 ¹ returns were received, which meant that the tax was enforced strictly upon the basis of sworn returns by tax payers, and not by official estimates. As was natural in the first year, many of the returns were defective, and the income tax department was put to a great deal of labor that will probably not be required in the future. In general, it was evident that the people were attempting to comply with the law, and that coöperation between the taxing authorities and the taxpayers had been secured to a very large extent. Up to January, 1918, about 9000 delinquents were rounded up by the department, and it was then estimated that further search might disclose some 10,000 other cases. These figures seem large; but when compared with the total number of returns received, they indicate that the law was as fully complied with as could have been expected of any similar act in the first year of its operation. There were, of course, many errors resulting from no dishonest intent, and caused in most cases by uncertainty as to the taxable status of stock dividends, shares of voluntary associations, and some other items. There were also about 4000 cases where questions of domicile were raised, but in most of these it was determined that the persons concerned were inhabitants of the commonwealth. Up to January 1, 1918, supplementary investigations made by the department brought in some \$300,000 of taxes.

¹ This was many times the number previously received in the state by the United States Internal Revenue Department which had ordinarily received 25,000 returns. Differences in the scope of the Federal and the state tax account in part for the smaller number of returns to the Federal government, but it was noted that in the spring of 1917 the enforcement of the state law resulted in a substantial increase in the number of returns received by the Federal authorities.

The amount of taxes assessed under the new law was as follows:

Tax on interest and dividends.....	\$8,697,503
Tax on business and professional incomes.....	2,577,061
Tax on gains from dealings in intangible property	836,234
Tax on annuities.....	24,211
	<hr/>
Total.....	\$12,135,009 ¹

Up to March 21, 1918, abatements amounting to \$140,784 had been granted, but additional assessments made the total tax assessed at that date \$12,119,000, of which sum \$11,929,000 had actually been collected. Ninety-four per cent of the taxes assessed on September 1, 1917, had been paid by October 15, when interest began to accrue, and three per cent more were collected by November 15. The \$189,449 of uncollected taxes outstanding on March 21, 1918, represented approximately one and one-half per cent of the taxes that had been assessed.

The cost of administering the new act was large, but not excessive, and amounted to \$301,502. Of this sum, \$40,668 had been expended for office equipment and publicity work which were incidental to the establishment of the new system, so that the ordinary cost of administration was \$260,834, which represents about two per cent of the amount of the tax that will be collected. Moreover, this figure should be reduced by \$36,977, to allow for interest accruing upon income tax balances, so that the net cost of collection can be estimated at 1.86 per cent, a figure which compares favorably with the cost of collecting other income taxes.

¹ Of this amount \$462,300 is estimated.

THE FINANCIAL RESULTS

The yield of the tax materially exceeded the estimates. The income tax act was premised upon estimates, made May 16, 1916, that the six per cent tax levied by the proposed law upon interest and dividends would yield \$8,000,000 and upwards, and that the one and one-half per cent tax levied upon business and professional incomes would yield from \$750,000 to \$1,500,000. No attempt was made to estimate the yield of the three per cent tax upon gains from dealings in intangible property, since there were no data upon which an estimate could be based.

The actual yield, it will be noticed, of the six per cent tax on interest and dividends was \$8,697,000, which corresponded very closely with the estimate of \$8,000,000 and upward. The tax on business and professional income actually yielded \$2,577,000, which greatly exceeded the highest estimate. The yield of the three per cent tax on dealings in intangible property was \$836,000. Instead of an estimated yield of from nine to ten millions from the various taxes provided by the act, the law of 1916 has yielded over twelve millions.

These statistics need to be compared with those showing the revenue derived from intangible property and personal and business incomes under the general property tax. The comparison is not easy for a number of reasons. In the first place, intangible property and personal and business income were taxed under the old system by a process of dooming, and in the assessors' returns were lumped with certain items of tangible personal property under the head of "all other ratable personal estate." This item totaled \$762,636,000 in the year 1916; and there is an official estimate ¹ that, of this

¹ *Aggregates of Property, Taxes, etc., 1916, Part II, p. 86.*

amount, \$112,854,000 represented tangible personal property, \$610,774,000 represented intangible personal property, and \$39,008,000 represented business and professional incomes. But this estimate probably overstated the amount of intangible property.

The second reason is that in 1916 local assessments of intangible property were greatly increased in a number of cities and towns, purely as a result of the enactment of the income tax act. If that law had not been on the books, personal property in these cases would have been doomed for about the same amount as in 1915. But the enactment of the law freed boards of assessors from the fear of driving wealthy inhabitants out of town, since emigration would not enable tax payers to avoid 1916 taxes and a new system was going into operation the following year. It is, therefore, not fair to make the 1916 assessments of personal property the basis of comparison. In the entire commonwealth assessments of personal property rose from \$1,195,098,000 in 1915 to \$1,275,754,000 in 1916, an increase of \$80,656,000, which was larger than normal.

In the third place, the income tax act provided that no assessment of personal property in 1917 should be reduced below the amount assessed in 1916 unless the taxpayer come forward with a sworn return of his tangible personal property which was all that remained subject to local taxation. The result was that the exemption of intangible property and of income from local taxation could not and did not decrease local assessments as much as it would otherwise have done, which is merely another way of saying that tangible personal property was assessed for considerably more than in 1915. In the entire commonwealth the assessment of personal property declined from \$1,275,754,000 in 1916 to \$730,591,000 in 1917. Here is a shrinkage of

\$545,163,000, which would have been greater if tangible personal property had not been more fully assessed in 1917, and would have been less if assessments of personal property had not been materially increased in 1916 as a result of the passage of the income tax act. How far the two things offset each other no one knows or ever will know.

The income tax act made the year 1915 the point of departure by providing that the revenue from the income tax should be distributed by the state to the various cities and towns on a twofold basis. In the first place, each town was to receive an amount that would, on the basis of its 1915 revenues, compensate it for the loss occasioned by the exemption of intangible property and business and professional incomes. In the second place, any balance remaining was to be divided among the cities and towns in the same proportion that was followed in levying the direct state tax. Upon this basis it was determined that \$8,120,621¹ was needed to compensate the cities and towns for the exemption of intangible property and business and professional incomes. And probably this is the fairest basis from which to estimate the financial results of the new law.

The income tax will probably yield in 1917 over \$12,000,000 after all allowance is made for abatements, and this is from three to four millions more than intangible property and incomes contributed under the general property tax. The net increase of revenue, however, was somewhat less because the administration of the tax cost in its first year about \$300,000.

¹ This figure agreed very closely with that given in the estimate of May 16, 1916. In this estimate it was computed that intangible property contributed from \$8,000,000 to \$8,600,000 to local taxation in the year 1915

III. COMPARISON WITH THE TAXATION OF INTANGIBLE PROPERTY UNDER THE GENERAL PROPERTY TAX

The comparison of the amount of interest and dividends taxed under the new law with the amount of intangible property that was probably taxed under the old system may be of interest. The six per cent tax on interest and dividends yielded, as above stated, \$8,697,000, which represented an assessment of \$144,950,000 of interest and dividends. Under the old system, the estimate of May 16, 1916, indicated that from \$500,000,000 to \$540,000,000 of intangible property was locally assessed in 1915; and in point of fact the shrinkage in the personal property assessed in 1917 was exactly \$545,000,000. It is safe to say, therefore, that under the general property tax, locally administered, Massachusetts assessed property with a capital value of some \$550,000,000; while under the income tax, administered by the state, it assessed approximately \$145,000,000 of interest and dividends. If we capitalize the interest and dividends at six per cent, we obtain a capital value of \$2,400,000,000 of intangible property reached under the income tax in the year 1917.

In this connection it should be taken into account that the income tax act exempted \$300 of interest and dividends to people whose total income did not exceed \$600, and that this exemption appears to have decreased the assessment of income by about \$2,000,000, representing about \$33,000,000 of capital value. Moreover, the act exempted trust funds held by a resident trustee for a non-resident beneficiary, which appears to have led to an exemption of \$3,300,000 of income having a capital value, at six per cent, of over \$50,000,000. It is further to be remembered that the six per cent rate of capitalization adopted in this calculation tends to under-

estimate rather than overestimate the capital value of the intangible property reached under the new act. If the net result is stated in terms of capital values, Massachusetts can claim to have increased the assessment of intangible property from \$550,000,000 to \$2,400,000,000 in a single year, and that, too, in spite of exemptions amounting to more than \$80,000,000 more.

The act has so far occasioned little litigation. In the case of *Trefry v. Garfield* (227 Mass. 522), the Supreme Court of Massachusetts held that stock dividends, stockholders' "rights," and dividends earned prior to 1916 were taxable. In the later case of *Falkner v. Trefry* the court held that the act did not apply to income received in 1916 prior to the death of a person who died in November. Only two other cases are pending at the time of writing.

The recently issued report of the State Tax Commissioner declared that the act of 1916 has given general satisfaction.¹ It states that the wealthy are now paying more than they did under the old system, while persons of small means have received exemptions they did not formerly enjoy. It notes that the law has brought an incidental benefit to many people who have been obliged to install better systems of bookkeeping than they formerly employed, and reports that the tax department is aiding taxpayers, without charge, in installing simple but adequate bookkeeping systems. It concludes: "Both from the point of revenue and the public's satisfaction, the law has proven a decided success. An equitable tax has been substituted for one that was driving wealth from the state."

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¹ Report of Tax Commissioner, 1917, p. 19